Chapman and Cutler LLP

Chapman Client Alert

October 2, 2017 Current Issues Relevant to Our Clients

MSRB Publishes its 2017 Compliance Advisory for Broker-Dealers

The Municipal Securities Rulemaking Board ("*MSRB*") recently published its 2017 Compliance Advisory for Brokers, Dealers and Municipal Securities Dealers. The Compliance Advisory outlines several MSRB rules that the MSRB believes present key compliance risks for brokers, dealers and municipal securities dealers ("*dealers*"). In order to mitigate exposure to those compliance risks, the Compliance Advisory provides dealers with non-exhaustive lists of factors to consider when evaluating compliance procedures and controls. The MSRB intends for dealers to use the advisory as a tool to supplement their evaluations of the adequacy of their compliance programs. The MSRB also intends for the Compliance Advisory to assist the Securities and Exchange Commission ("*SEC*") and Financial Industry Regulatory Authority, Inc. ("*FINRA*") in the development of regulatory examination programs for dealers conducted by the SEC and FINRA. You can obtain a copy of the Compliance Advisory here. The SEC and FINRA have separately published their annual examination priorities. For more information on those publications, please see our related Client Alerts available here and here.

Compliance Risks

The Compliance Advisory highlights the compliance risks related to several MSRB rules described below and outlines factors that the MSRB suggests dealers consider when evaluating compliance with these rules.

Professional Qualification Standards (Rules G-2, G-3 and A-12): Dealers, municipal advisors and their associated persons must be qualified in accordance with MSRB rules to conduct municipal securities or advisory activities. A firm engaging in municipal advisory activities must also first register as a municipal advisor with the SEC before registering with the MSRB. The MSRB reminds dealers to monitor their activity to ensure that appropriate registrations are in place prior to engaging in a new activity, such as acting as a municipal advisor.

Best Execution and Fair Pricing Standards (Rules G-18 and G-30): A dealer must purchase from or sell to a customer at an aggregate price (including any mark-up or mark-down) that is fair and reasonable if acting as principal, and at fair and reasonable commissions if acting as agent. Under MSRB Rule G-18 (Best Execution), dealers are also required to use reasonable diligence to ascertain the best market for a municipal security in any transaction for or with a customer and buy or sell in that market so that the price to the customer is as favorable as possible under prevailing market conditions. A dealer must have sound policies and procedures reasonably designed to achieve best execution.

Standards of Conduct in the Performance of Financial Advisory Activities (Rule G-23): A dealer with a financial advisory relationship with a municipal entity with respect to the issuance of municipal securities may not underwrite that issuance. The MSRB notes that a dealer that clearly identifies itself in writing as an underwriter at the earliest stages of its relationship with an issuer will generally not be considered to be acting as a financial advisor. However, a dealer should be mindful that the statutory definition of "municipal advisor" is very broad and the provision of advice that would not prohibit the dealer under MSRB Rule G-23 from being an underwriter could still cause the dealer to become a municipal advisor.

Fair Dealing with All Persons in the Conduct of Municipal Securities Activity (Rule G-17): Dealers must deal fairly with all persons and not engage in any deceptive, dishonest or unfair practice with respect to municipal securities activities. This obligation exists in the absence of fraud and applies to activities with investors and all other market participants. The duty under MSRB Rule G-17 requires a dealer acting as the underwriter in a negotiated underwriting to make specific disclosures to the issuer to clarify the dealer's role in the issuance and to disclose any actual or potential material conflicts of interest with respect to the issuance.

Pay-to-Play Restrictions (Rule G-37): Dealers may not engage in municipal securities business from municipal entities for two years after a triggering contribution has been made to an official of a municipal entity by the dealer, subject to certain exceptions. The rule also prohibits dealers from doing indirectly what the rule prohibits them from doing directly, and includes

tailored prohibitions on soliciting and coordinating contributions or payments to certain officials of a municipal entity or certain political parties of states and localities, respectively. Dealers must report information regarding certain contributions to the MSRB on a quarterly basis.

Time of Trade Disclosure to Customers (Rule G-47): Dealers are prohibited from selling to or purchasing from a customer without disclosing all material information known about the transaction and the material information about the security that is reasonably accessible to the market. A dealer must make this disclosure at or prior to the time of trade either orally or in writing and should be able to document that the disclosure was made. The disclosure requirement applies to all transactions regardless of whether the transaction is solicited or unsolicited but does not apply to transactions with "sophisticated municipal market professionals" if the dealer obtains required affirmations.

Supervisory Procedures and Books and Records (Rules G-27, G-8 and G-9): Dealers must supervise the conduct of their municipal securities activities and establish a supervisory system that is reasonably designed to achieve compliance with applicable securities laws and regulations and MSRB rules. Dealers are also subject to a variety of recordkeeping requirements, such as the requirement to make and keep certain records applicable to its business, including account records, securities records, customer complaint records and records concerning compliance with its supervisory obligations. Dealers are also generally required to preserve such records in a readily accessible manner for a period of at least two years.

What To Do Now

By highlighting some key compliance risks and providing considerations tailored to those risks, the Compliance Advisory attempts to aid dealers in developing and assessing effective compliance programs. Dealers should consider reviewing their firm's existing compliance policies and procedures in light of the considerations discussed in the Compliance Advisory.

For More Information

If you would like to discuss any topic covered in this Client Alert, please contact a member of the Investment Management Group or visit us online at chapman.com.

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